Supreme Court, U.S.
FILED
NOV 27 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-762

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

THELMA T. METGE, Executrix of the Estate of August Metge, and ELIZABETH G. SHEPARD, on behalf of themselves and on behalf of all others similarly situated,

Cross-Petitioners,

vs.

BANKERS TRUST COMPANY,

Cross-Respondent.

On Cross-Petition For A Writ of Certiorari to the United States Court of Appeals For the Eighth Circuit (Cross-Petition to No. 85-555, October Term, 1985)

BRIEF OF CROSS-RESPONDENT BANKERS TRUST COMPANY, IN OPPOSITION

BENNETT A. WEBSTER
ROBERT A. GAMBLE
KAREN J. LAMP
GAMBLE, RIEPE, WEBSTER, DAVIS & GREEN
2600 Ruan Center
Des Moines, Iowa 50309
(515) 243-6251

Attorneys for Cross-Respondent, Bankers Trust Company

St. Louis Law Printing Co., Inc., 411 No. Tenth Street 63101 314-231-4477

BEST AVAILABLE COPY

QUESTION PRESENTED

WERE THE DISTRICT COURT AND THE EIGHTH CIRCUIT COURT CORRECT IN HOLDING THAT THERE IS NO GENUINE ISSUE OF MATERIAL FACT THAT THE BANK (BTC) WAS A CONTROLLING PERSON OF THE PRIMARY VIOLATOR WITHIN THE MEANING OF § 20(a) OF THE SECURITIES EXCHANGE ACT, 15 U.S.C. § 78t?

PARTIES TO THE PROCEEDINGS

A Statement Relative to Rule 28.1, parties to the proceedings on behalf of Cross-Respondent, Bankers Trust Company, is set forth in the Petition for Writ of Certiorari of Petitioner, Bankers Trust Company, docketed in this Court on September 27, 1985, as No. 85-555.

TABLE OF CONTENTS

	Page
Question Presented	i
Parties to the Proceedings	ii
Table of Contents	iii
Table of Authorities	iv
Opinions Below	1
Jurisdiction	2
Provisions of Statutes and Rules Involved	2
Statement of the Case	2
Statement of the Facts	2
Reasons for Affirming the District and Circuit Courts	4
This Court Should Grant Certiorari Both As To The Aiding-Abetting And Controlling Person Aspects Of This Case, Matters Which Have Not Heretofore Been Considered By This Court, But Should Affirm The District Court And Eighth Circuit Court Of Appeals On The Question Of Controlling Person Liability And Reverse On The Question Of Aiding-Abetting	4
Argument	4
The District Court And The Eighth Circuit Court Were Correct In Holding That There Is No Genuine Issue Of Material Fact That The Bank (BTC) Was A Controlling Person Of The Primary Violator Within The Meaning Of § 20(a) Of The Securities Exchange Act, § 78t	4
Conclusion	9

TABLE OF AUTHORITIES

Page

Cases:

Burgess v. Premier Corp., 727 F.2d 826, 832 (9th Cir. 1984) 4

Christoffel v. E. F. Hutton & Co., 588 F.2d 665, 668 (8th Cir. 1978) 4

G. A. Thompson & Co. v. Partridge, 636 F.2d 945 (5th Cir. 1981) 5

Gordon v. Burr, 506 F.2d 1080, 1085-1086 (2nd Cir. 1974) 4

Holloway v. Howerdd, 377 F. Supp. 754 (M.D. Tenn. 1973) 5

Rochez Brothers, Inc. v. Rhoades, 527 F.2d 880, 889-892 (3rd Cir. 1975) 4

Sanders v. John Nuveen, 524 F.2d 1064, 1072 (1975) ... 7

Stern v. American Bankshares Corp., 429 F. Supp. 818 (E.D. Wis. 1977) 5

Statutes and Rules:

Section 20(a), Securities Exchange Act, 15 U.S.C. § 78t . 3, 5, 6, 8, 9

Other Authorities:

Lehr, *Some Securities Law Issues in Lending on Pledged Stock*, 38 Bus. Law 91 (Nov. 1982) at 191 6

No. 85-762

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

THELMA T. METGE, Executrix of the Estate of August Metge, and ELIZABETH G. SHEPARD, on behalf of themselves and on behalf of all others similarly situated,

Cross-Petitioners,

vs.

BANKERS TRUST COMPANY,

Cross-Respondent.

On Cross-Petition For A Writ of Certiorari to the United States Court of Appeals For the Eighth Circuit (Cross-Petition to No. 85-555, October Term, 1985)

BRIEF OF CROSS-RESPONDENT BANKERS TRUST COMPANY, IN OPPOSITION

Cross-Respondent, Bankers Trust Company, respectfully opposes the Cross-Petition for Writ of Certiorari by Cross-Petitioners to review the judgment of the United States Court of Appeals for the Eighth Circuit.

OPINIONS BELOW

The Opinion of the Court of Appeals is reported at 762 F.2d 621 (8th Cir. 1985), and the opinion of the District Court is

reported at 577 F. Supp. 810 (S.D. Iowa 1984). Both opinions are reproduced in the Appendix to Bankers Trust Company's Petition for Writ of Certiorari filed with this Court on September 27, 1985.

JURISDICTION

See Petition for Writ of Certiorari filed by Bankers Trust Company, at page 2.

STATUTES AND REGULATIONS INVOLVED

See Petition for Writ of Certiorari filed by Bankers Trust Company, at pages 2-3.

STATEMENT OF THE CASE

The Bank adopts the first paragraph of Cross-Petitioners' Statement of the Case, pursuant to Sup. Ct. R. 34.2.

STATEMENT OF FACTS

Plaintiffs' Cross-Petition for Writ of Certiorari on the question of controlling person liability relies upon the Statement of Facts contained in the Brief in Opposition to the Bank's Petition for Certiorari. The first four pages of that Brief (pp. 4-7) relate to events which occurred long before the Bank loans here involved and which primarily involve dealings of the Bank with the Woodland Corporation, a corporation wholly unrelated to any of the parties in this case. These facts are completely irrelevant to the issue of control. Plaintiffs continue the recital of alleged facts which occurred after May 10, 1974, when sales of the Thrift Certificates had ceased and even after the bankruptcy of IEI. (Pp. 18-19). These facts are irrelevant, as no violation was occurring. Plaintiffs' Statement of Facts is not supported by the record and alleges that the Bank did not lose money on the IEI loan (p. 20). Plaintiffs did not make this assertion in the District Court or in the Eighth Circuit, and it is contrary to the Findings of Fact of the District Court. (Ap. B, A-24).

Chief Judge Stuart accurately set forth and facts relative to alleged control person liability and these are largely repeated by the Eighth Circuit. Plaintiffs rely upon ordinary restrictive covenants in term loan agreements (boilerplate), such as are used by all banks, and upon facts which occurred after the violation had ceased. Plaintiffs rely upon covenants which require the Bank's permission for additional borrowing in excess of $100,000, which restrict the payment of dividends, sale of capital assets and similar ordinary term loan covenants. These, of course, are not indicia of "control", and if so would make every banker-lender a controlling person.

Plaintiffs rely primarily upon events which occurred several months after the sale of Thrift Certificates ceased on May 10, 1974. On pages 18 and 19 of their Brief in Opposition they recite these facts which are, of course, wholly irrelevant to the issue here presented. Judge Stuart correctly found that in order to be liable under § 20(a) that the alleged controlling person must be in control *at the time of the violation* and not at some other time. The Bank was not in day-to-day contact with IEI or its officers. It attended one board meeting of IEI immediately before May 10, 1974. All of IEI's officers and directors testified in detail that the Bank did not concern itself with the day-to-day operations of the company and was not in control either of the Thrift Certificate program or of the corporation itself. These facts are uncontradicted as Judge Stuart found. Even accepting Plaintiffs' Statement of Facts at face value, there can be no Bank liability as a controlling person for the reasons stated by the District and Circuit Courts.

REASONS FOR AFFIRMING THE DISTRICT AND CIRCUIT COURTS

This Court should grant certiorari both as to the aiding-abetting and controlling person aspects of this case, matters which have not heretofore been considered by this Court, but should affirm the District Court and Eighth Circuit Court of Appeals on the question of controlling person liability and reverse on the question of aiding-abetting.

ARGUMENT

The District Court And The Eighth Circuit Court Were Correct In Holding That There Is No Genuine Issue Of Material Fact That The Bank (BTC) Was A Controlling Person Of the Primary Violator Within The Meaning Of § 20(a) Of The Securities Exchange Act, 15 U.S.C. § 78t.

In their Cross-Petition for Certiorari plaintiffs criticize the rule for controlling person liability formulated by Chief Judge Stuart and adopted by the Eighth Circuit. In fact, Judge Stuart having found two different views of a "control person" in the Circuits, adopted the view most favorable to the plaintiffs. The Second and Third Circuits have adopted the "culpable participation rule" - that an alleged controlling person cannot be liable unless he culpably participates in the primary fraud. *Rochez Brothers, Inc. v. Rhoades,* 527 F.2d 880, 889-892 (3rd Cir. 1975); *Gordon v. Burr,* 506 F.2d 1080, 1085-1086 (2nd Cir. 1974). The Ninth Circuit follows a similar view, holding that the controlling person must have at least participated in the activities giving rise to the violation. *Christoffel v. E. F. Hutton & Co.,* 588 F.2d 665, 668 (8th Cir. 1978). *See* 577 F. Supp. 815. Since Judge Stuart's opinion, the Ninth Circuit has adhered to this view in *Burgess v. Premier Corp.,* 727 F.2d 826, 832 (9th Cir. 1984). Judge Stuart found this view unnecessarily burdensome to plaintiffs and held that proof of culpable participation or participation in the activities which gave rise to the violation

is unnecessary. He noted that the Fifth Circuit had rejected this view in *G. A. Thompson & Co. v. Partridge*, 636 F.2d 945 (5th Cir. 1981), holding that lack of participation and good faith are affirmative defenses under the statute (citing cases in accord, p. 816 including *Stern v. American Bankshares Corp.*, 429 F. Supp. 818 (E.D. Wis. 1977) and *Holloway v. Howerdd*, 377 F. Supp. 754 (M.D. Tenn. 1973)). In a scholarly analysis, Judge Stuart then determined that a plaintiff must show that a defendant banker-lender was a person who directly or indirectly controlled the primary violator *at the time of the violation*. He reasoned that a lending bank should have no higher duty and should not be subject to a more stringent test of control than a director, which again is a finding favorable to the plaintiff, for requiring a greater finding of control for a lender than a director directly charged with responsibility for the business would seem logical. He concludes that for a director or lender to be liable, it must be shown that the director or lender "exercised its power by becoming involved in the *general operations* of the corporate borrower". Judge Stuart relied upon *Stern* and *Holloway* in formulating this test, which follows the Fifth Circuit rule more favorable to plaintiffs than the stricter rule of the Second, Third and Ninth Circuits. The Eighth Circuit reviewed and adopted Judge Stuart's analysis.

Plaintiffs in the District and Circuit Courts, as well as here, rely primarily upon alleged activities of the Bank after May 10, 1974, when the violation had ceased. As bankruptcy approached and the Bank was more often in contact with its debtor, IEI, plaintiffs point to attendance at board meetings of a subsidiary and the attempts to save it from bankruptcy to show control. Plaintiffs urge this Court and urged the Courts below to adopt a test where mere unexercised and unripened power to control is alone a sufficient basis on which to posit control liability under § 20(a), even though this power to control is merely putative or contingent and can only arise in the future on the occurrence of certain events, such as declaring default and calling the loan.

This standard would make every banker-lender a controlling person unless the debtor could in fact pay off the note in full when due.

As Judge Stuart points out, any modern term loan agreement of a bank with its borrower contains numerous restrictive covenants which inevitably give a measure of control and particularly future control on the happening of certain events such as default or "calling the note". In fact, as Judge Stuart noted, every lender has some power over a borrower, particularly if the borrower does not have sufficient cash to pay off the loan when it becomes due. Every "balloon note" which has substantial amount due at the end of the term contemplates that it will be extended if interest and principal due are paid and conditions oterwise warrant extension. Congress did not intend that every lender in this situation would be a controlling person within the meaning of § 20(a), as Judge Stuart properly found.

Plaintiffs assert that "previous decisions involving lender liability under § 20(a) have not found it necessary to modify adopted standards and definitions to protect lenders". No authority is cited for this statement and none can be, as Judge Stuart correctly found that "the Court is aware of no cases in which such liability has actually been imposed on a lender". See also Lehr, *Some Securities Law Issues in Lending on Pledged Stock,* 38 Bus. Law 91 (Nov. 1982) at 191 where the author states:

> Notwithstanding assertion of pledgee voting rights, a pledgee usually does not have a direct or active relationship with the issuer. The risk of 20(a) (control) liability for the issuer's acts therefore appears minimal. *We found no case holding a pledgee liable under 20(a) for the acts of an issuer.* (Emphasis added).

It must further be noted that the Bankruptcy Judge in the IEI bandruptcy proceedings found that the IEI stock held by the Bank was held as collateral and that the Bank was not a stockholder.

Plaintiffs have admitted that the United States District Court for the Southern District of Iowa entered an Order on June 8, 1979, in the bankruptcy proceedings of Investors Equity, Inc. discussing this issue of whether or not the Bank owned the 50,000 shares of IEI stock or whether it was merely collateral for the Bank's loans to IEI. The Court found that the "put and call" arrangement is a recognized means of securing a loan and ruled that the Bank was not a shareholder but a creditor, stating:

> The parties here did not bargain for an absolute sale. Consider that the basic agreement was for a loan of money, there was more than one form of collateral taken, the stock agreement of paragraph 5 was only a portion of the contract and Investors paid "interest" on the consideration. *This was beyond question a loan and security agreement.* The underlying loan survives. (Emphasis added).

In *Sanders v. John Nuveen,* 524 F.2d 1064, 1072 (1975), the Seventh Circuit, in an opinion by Justice Stevens, discussed the question of control. It held that an underwriter was responsible for representations made in the sale of stock and has a duty to make at least some investigation into a company issuing stock which it underwrites. It further held, however, that a corporation was not in control of another corporation which controlled the underwriter by virtue of 40% stock ownership and was not liable as a controlling person for failure of the underwriter to make proper investigation of the issuer's short term commercial paper where such corporation never took any part in the management of the underwriter. Justice Stevens stated, at p. 1072:

> The situation is rather different as regards Alleghany Corporation. Alleghany is primarily an investor. Although it was in control of IDS by virtue of its 40% stock ownership and because officers and directors of Alleghany acted as officers and directors of IDS, it was never shown that

> Alleghany took any active part in the management of Nuveen; rather, it delegated this task to IDS. The judgment against Alleghany should therefore be reversed.

Here the Bank held 17% of the stock of the company as collateral, not 40% as an investment as in the *Sanders* case. here the Bank took no active part in the management of IEI. The "active part in the management" test formulated by Justice Steven in *Sanders* appears to be the same test here adopted by the District and Circuit Courts.

Despite plaintiffs' protestations, this was an ordinary lending transaction and the restrictive covenants in the loan agreement were usual and customary covenants between banker-lenders and borrowers. The Bankruptcy Court in the IEI bankruptcy and the District Court and the Eighth Circuit in this case have all found that this was a lender-borrower relationship and the latter two Courts have correctly held that the Bank was not a controlling person within the meaning of § 20(a).

CONCLUSION

As there is some difference of opinion in the Circuits as to the basis of §20(a) liability, it would be well for this Court to consider the question as well as aiding-abetting liability. It should reverse the Court of Appeals for the Eighth Circuit as to aiding-abetting liability and affirm as to control person liability.

Respectfully submitted,

Bennett A. Webster
Robert A. Gamble
Karen J. Lamp

GAMBLE, RIEPE, WEBSTER,
DAVIS & GREEN
2600 Ruan Center
Des Moines, Iowa 50309
Telephone: (515) 243-6251
Attorneys for Cross-Respondent

DATED: November 25, 1985